

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-02 INR-07
L-03 NSAE-00 NSC-05 PA-02 PRS-01 SP-02 SS-15
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FM USMISSION USBERLIN
TO SECSTATE WASHDC 5440
DEPT OF TREASURY WASHDC
INFO AMEMBASSY BONN

UNCLAS SECTION 1 OF 2 USBERLIN 2601

E O 11652: NA

TAGS: OVIP (BLUMENTHAL, W. MICHAEL): WB, GW, EINV
SUBJ: VISIT TO BERLIN OF SECRETARY BLUMENTHAL: SENAT OUTLINES ITS
VIEWS ON NEGATIVE IMPACT OF US TAX LAW ON BERLIN PREFERENCES

REF: (A) USBERLIN A-126, 9 SEPT 77, (B) USBERLIN 2822

1. BEGIN SUMMARY: MISSION TRANSMITS HERewith SHORT BERLIN
SENAT PAPER DISCUSSING TAX ISSUE WHICH GOVERNING MAYOR IN-
TENDS TO RAISE DURING SECRETARY BLUMENTHAL'S VISIT TO BERLIN.
THE SENAT BELIEVES AMERICAN TAX TREATMENT OF DISTRIBUTED
PROFITS AND SPECIAL BERLIN DEPRECIATION SCHEDULES UNDERCUTS
PURPOSE OF FRG TAX RELIEF SCHEME FOR BERLIN AND DISCOURAGES
NEW AMERICAN INVESTMENT IN CITY. END SUMMARY.

2. THE FOLLOWING PAPER SUPPLEMENTS VIEWS OF BERLIN CHAMBER
OF INDUSTRY AND COMMERCE ON SAME ISSUE TRANSMITTED IN
USBERLIN A-126 OF SEPTEMBER 9. SENAT HOPES FOR SYMPATHETIC
US REVIEW OF THIS PROBLEM BECAUSE BOTH COUNTRIES HAVE
STRATEGIC INTEREST IN MAINTAINING VIABILITY OF CITY.
THEY BELIEVE PRESENT US TAX POLICY IN THIS INSTANCE
SOPS UP TAX REVENUES WHICH FRG WOULD OTHERWISE COLLECT
AND DETERS FURTHER US INVESTMENT. (BERLIN PREFERENCE
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SCHEMES ARE DESIGNED IN PART SIMPLY TO OVERCOME IN-
CREASED COSTS OF DOING BUSINESS IN BERLIN ATTRIBUTABLE
TO POST-WAR GEOPOLITICAL FACTORS. BACKGROUND MATERIAL
ON UNDERLYING ECONOMIC SITUATION OF BERLIN IS CONTAINED
USBERLIN A-61, 21 APRIL 77, PP 3-10.

3. BEGIN BERLIN PAPER:

QUOTE: IN THE TAXATION PROCEDURE, PROFITS DISTRIBUTED TO US CORPORATIONS ARE SUBJECT TO CORPORATION INCOME TAX OF 48 PERCENT (PLUS ADDITIONAL STATE TAXES). THE GERMAN TAXES ON EARNINGS ARE TAKEN INTO ACCOUNT IN THE FORM OF A TAX CREDIT BUT THIS IS LIMITED TO THE AMOUNT OF US TAX DUE ON THESE EARNINGS, I.E. THERE IS NO COMPENSATION FOR HIGHER GERMAN TAXATION. AMERICAN COMPANIES HAD TWO OPTIONS TO CHOOSE FROM IN THE PAST. FOREIGN EARNINGS AND DEDUCTABLE TAXES COULD BE ASSESSED EITHER "OVER-ALL" OR "PER COUNTRY" FOR US TAXATION PURPOSES. BOTH OPTIONS MEANT THAT HEAVILY TAXED FOREIGN EARNINGS COULD BE COMBINED WITH LOW-TAXED FOREIGN EARNINGS, THUS INCREASING THE AMOUNT OF TAX CREDIT AND OFFSETTING AN EXCESSIVE TAX CREDIT, IN THE CASE OF OVER-ALL ASSESSMENT FOR TAXES IMPOSED BY SEVERAL COUNTRIES, IN THE CASE OF PER COUNTRY ASSESSMENT FOR DIFFERENT TAX BURDENS IN ONE COUNTRY, E.G. BERLIN EARNINGS AND WEST GERMAN EARNINGS. NOW ONLY THE OVER-ALL ASSESSMENT IS POSSIBLE.

4. THIS MEANS THAT THE CORPORATION TAX REDUCTIONS PURSUANT TO ART. 21 OF THE BERLIN FG (BERLIN PROMOTION LAW) ARE FULLY PRESERVED WHEN THERE IS A COMPLETE RETENTION OF ALL INCOME OF THE BERLIN SUBSIDIARY, AND LARGELY MAINTAINED IN A PARTIAL RETENTION OF THE SAME INCOME. IN THE CASE OF AMERICAN COMPANIES MAKING A FULL CAPITAL

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DISTRIBUTION, THERE MAY BE SUPPLEMENTARY TAXATION DUE ON THE DIFFERENCE BETWEEN REDUCED GERMAN TAXATION AND HIGHER US TAXATION. THIS MEANS A PARTIAL LOSS OF THE BERLIN PREFERENCES.

5. PROBLEMS ALSO ARISE IN THE UTILIZATION OF INCREASED DEPRECIATION ALLOWANCES PURSUANT TO THE BERLIN PROMOTION LAW. THE US TAX AUTHORITIES DO NOT RECOGNIZE THESE INCREASED DEPRECIATION ALLOWANCES AND USE THE NORMAL AMERICAN DEPRECIATION ALLOWANCES AS A BASIS FOR ASCERTAINING PROFITS. THEREFORE THE TAX DEFERRAL EFFECT IN THE YEAR OF INVESTMENT CANNOT ARISE BECAUSE THE LOW GERMAN TAXATION, DUE TO THE DEPRECIATION PREFERENCE, IS RAISED TO THE HIGHER US TAX LEVEL (HIGHER, ABOVE ALL, DUE TO THE TAXATION BASIS) AND BECAUSE IN SUBSEQUENT YEARS THE GERMAN TAXATION, THEN HIGHER, (HIGHER PROFITS BECAUSE ONLY A REMNANT OF THE DEPRECIATION ALLOWANCES REMAINS) LEADS TO EXCESSIVE TAX CREDITS WHICH CAN HARDLY BE OFFSET UNLESS NEW INVESTMENTS ARE CONSTANTLY MADE IN ORDER TO OBTAIN FURTHER INCREASED DEPRECIATION ALLOWANCES.

6. THE OVER-ALL SYSTEM IS ALSO A BAR TO A STRONG BERLIN COMMITMENT BY US COMPANIES BECAUSE THERE ARE VERY FEW LOW-TAXATION COUNTRIES LEFT TO ALLOW THE OFFSETTING OF EXCESSIVE TAX CREDITS.

7. THE SAME PROBLEM THAT ARISES IN CLAIMING INCREASED DEPRECIATION ALLOWANCES PURSUANT TO ART. 14 OF THE BERLIN FG ALSO COMES UP IN CLAIMING TAX-FREE INVESTMENT BONUSES PURSUANT TO ART. 19 OF THE BERLIN FG.

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USIA-15 EB-08 COME-00 OMB-01 /079 W

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8. A POSSIBLE SOLUTION COULD BE THE EXEMPTION FROM US TAXATION OF BERLIN EARNINGS OF US SUBSIDIARIES, A SYSTEM ALREADY PRACTISED FOR GERMAN EARNINGS IN FRANCE AND GREAT BRITAIN. THIS WOULD MEAN THAT THE BERLIN PREFERENCES ARE FULLY PRESERVED IN ALL CASES, WHICH IN TURN WOULD STRENGTHEN US COMPANIES' INTEREST IN BERLIN AND INCREASE BERLIN'S ECONOMIC STRENGTH. AN EXEMPTION PROCEDURE WOULD ALSO SOLVE THE PROBLEMS ARISING FROM THE NON-RECOGNITION OF INCREASED DEPRECIATION ALLOWANCES BY THE US TAX AUTHORITIES.

9. EXAMPLE 1. US PARENT COMPANY WITH WEST GERMAN SUBSIDIARY WITHOUT ENGAGEMENT IN BERLIN.

GERMAN TAXATION:	CALCULATION OF TAX CREDIT	
PROFITS	100	
-BUSINESS PROFITS TAX	13	13
INCOME SUBJECT TO CORPORATION		

TAX 87
 -CORPORATION TAX 56 PERCENT 49 PLUS 49
 REMAINING INCOME 38
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OWN CAPITAL 56
 FULL OWN CAPITAL DISTRIBUTION
 56 38
 PLUS 5/11 CORPORATION TAX
 REMISSION 17 -17
 CASH DIVIDEND 55
 -CAPITAL GAINS TAX 15 PERCENT 8 PLUS 8
 47 TAX CREDIT 53

US TAXATION:
 PROFITS 100
 -CORPORATION INCOME TAX 48
 PERCENT 48 -CORP INC. TAX 48
 CALCULATORY INCOME REMAINING 52 EXCESSIVE TAX CREDIT
 PLUS 5
 ISSUE 47 NOT ELIGIBLE FOR EQUALIZ-
 ATION IN ISOLATED ASSESSMENT.
 ULTIMATE INCOME REMAINING 47

10. EXAMPLE 2. US PARENT COMPANY WITH ENGAGEMENT IN
 BERLIN, EARNINGS SOLELY IN BERLIN, SUBJECT TO REDUCED
 TAXATION (ART. 21 IN CONJUNCTION WITH ART. 27 BERLIN FG),
 NO INCREASED DEPRECIATION ALLOWANCE.

GERMAN TAXATION: CALCULATION OF TAX CREDIT
 A) B)
 PROFITS 100
 -BUSINESS PROFITS TAX 13 13 13
 INCOME SUBJECT TO CORP. TAX 87
 -CORP. TAX (BERLIN REDUCTION) 36 PLUS 36 PLUS 36
 REMAINING INCOME 51
 OF THIS OWN CAPITAL 56 29
 OWN CAPITAL 36 13
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OWN CAPITAL 0 9
 (PURSUANT TO ART. 27 BERLIN FG)

A) FULL CAPITAL DISTRIBUTION 29 B) DISTRI- 29
 FROM OWN CAPITAL 56 BUTION FROM
 OWN CAPITAL 56

PLUS 5/11 CORP. TAX REMISSION 13 AND 13 -13 -13
FROM OWN CAPITAL 36 13 OWN CAPITAL
36 13
FROM OWN CAPITAL 0 9
-9/25 CORP. TAX INCREASE 3 PLUS 3
CASH DIVIDEND 61 55
-CAPITAL GAINS TAX 9 8 PLUS 9 PLUS 8
15 PERCENT 52 47 48 44

US TAXATION

PROFITS 100 100 TAX CREDIT 48 44
-CORP. INC. TAX 48 48 -CORP. 48 44
CALCULATORY INCOME REMAINING 52 52 INC. TAX 0 - 4
ISSUE 52 47 SUPPLE-
0 - 4 MENTARY
52 43 TAX (-)
END QUOTE. GEORGE

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Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment:
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Disposition Event:
Disposition History: n/a
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